Supreme Court, U.S.
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NO. _____

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

ETHEL M. WARDA,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

PETITION FOR WRIT OF CERTIORARI

PETER J. JOHNSON
Counsel for Petitioner
800 Port Street
St. Joseph, MI 49085
(616) 982-1100

JAY L. SCHULTZ
Co-Counsel for Petitioner
816 Ship Street
St. Joseph, MI 49085
(616) 983-0151

136 pp

QUESTIONS PRESENTED

1. Whether the court below erred when, sua sponte, it applied the doctrine of judicial estoppel in this gift tax case where the requirements for application of the doctrine, as recognized by other federal circuits, had not been satisfied, and by so holding created conflicts with decisions of other federal circuits in similar matters; and

2. Whether the court below erred by alternatively holding that Petitioner was not merely the constructive trustee of the property she transferred, and by so holding decided the matter inconsistently with decisions of the Supreme Court of Michigan in similar matters.

LIST OF PARTIES TO THE PROCEEDINGS IN THE COURT BELOW

The caption of the case in this Court contains the names of all parties to the proceedings in the United States Court of Appeals for the Sixth Circuit.

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IN THE UNITED STATES SUPREME COURT

October Term, 1993

ETHEL M. WARDA, Petitioner,
v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

Ethel M. Warda, Petitioner herein, respectfully requests that a writ of certiorari be issued to review the Judgment Order of the United States Court of Appeals for the Sixth Circuit, entered in the above-entitled case on January 26, 1994.

OPINIONS BELOW

The January 26, 1994 Judgment Order of the Court of Appeals for the Sixth Circuit sought to be reviewed is recommended for publication

and is reprinted in the Appendix to this Petition, pp. 1a-13a. The unreported judgment of the Probate Court of Berrien County, Michigan, entered December 4, 1992, is reprinted in the Appendix to this Petition, pp. 14a-66a. The decision of the United States Tax Court, entered January 22, 1992, is reported T.C. Memo. 1992-43, and is reprinted in the Appendix to this Petition, pp. 67a-90a.

JURISDICTION

The Judgment Order of the Court of Appeals was entered on January 26, 1994. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. Section 1254(1) and Rule 10.1(a) of the Supreme Court Rules.

STATUTE INVOLVED

This case involves Section 2501 of the Internal Revenue Code, as amended, 26 U.S.C. Section 2501, which provides as follows:

(a) Taxable Transfers. (1) General Rule. A tax, computed as provided in section 2502, is hereby imposed for each calendar year on the transfer of property by gift during such calendar year by any individual, resident or non-resident.

STATEMENT OF THE CASE

When Petitioner's father, William H. Matthews, died in 1953, he left an estate valued at $247,000. The primary asset of the estate was over 1,000 acres in farm land. There followed a will contest, resulting in a settlement pursuant to which Petitioner received legal title to the land. Approximately ten years later, when Petitioner's son, Henry Warda, became financially able to manage the farms himself, Petitioner began to transfer the farm land to her son. No gift taxes were paid on the transfers. Subsequently, the Commissioner assessed

deficiencies, penalties and interest which formed the basis of the present gift tax litigation.

Petitioner claimed that the transfers to her son were not taxable gifts because she initially took title to the farm land as a constructive trustee for the benefit of her son. In a 1992 Berrien County, Michigan probate proceeding, in which the Commissioner had appeared as a party, the court imposed a constructive trust upon all of Petitioner's inheritance from her father for the benefit of her son. The basis for imposing the constructive trust was serious irregularities, amounting to constructive fraud, in the original 1953 probate proceedings which resulted in approval of the settlement. However, the probate court in 1992 additionally found that it

was never Petitioner's intention to perpetrate any fraud.

The original 1953 will contest involved a first will, a second will revoking the first will, and a subsequent codicil to the revoked first will. The subsequent codicil to the revoked first will was drafted by a lawyer who did not know that the second will existed. The first will, filed for probate by the Petitioner, left the bulk of the estate to Petitioner. The second will, filed for probate by Matthew's widow, left the bulk of the estate to Petitioner's then minor son, Henry J. Warda. The widow's interest was basically identical under both wills. Michigan courts had never adjudicated the issue of whether a subsequent codicil to a revoked first will served to revive the revoked first will and to revoke the intervening second will. This

issue would have been an issue of first impression in Michigan.

With reference to Petitioner's motive for contesting the second will in 1953, the Tax Court record established that Petitioner always had her son's best interest at heart and that her intentions were never fraudulent. Petitioner, who had an abiding distrust of lawyers, did not have a working comprehension of the distinctions between life estates, remainder interests and bequests absolute. What she did "understand" in 1953 (or thought she did) was that if the second will was probated, the *entire family* -- both she and her son, Henry Warda, would lose the farms because the land would have come under the control of a trustee who knew nothing about farming and whom her father had come to distrust shortly before his death.

Further, Petitioner testified in the Tax Court that she had not personally read either of the two wills and that in advocating probate of the first will, she relied upon the advice which she received from her attorney to the effect that if the first will was probated, she would come to hold the farms in trust for her son.[1] Petitioner specifically testified that in signing the settlement agreement, it was never her intention to terminate her son's interest in the farms.

In the 1953 will contest, the Probate Court neither appointed a guardian ad litem to represent Henry Warda, Petitioner's minor son

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1 It should be noted that one of the reasons given by the probate court in 1992 for imposing a constructive trust was that Petitioner's attorney simultaneously served as her minor son's attorney, that the attorney's clients had conflicting interests, and that the attorney stood to personally gain $25,000 if the first will was probated.

and decedent's minor grandson, nor did it authorize independent legal counsel for the minor. One year earlier, Petitioner's husband, Anthony J. Warda, had been appointed the minor's guardian only for the purpose of selling a $165 easement. The minor's estate continued to remain open during the 1953 Matthews will contest only to administer the resulting $165 in easement proceeds.

Without making any effort to have his letters of authority to act as guardian reissued with respect to the will contest, Petitioner's husband immediately commenced to act in the name of the minor with respect to the will contest in which his wife and ward had diametrically opposed interests. As guardian, Anthony J. Warda filed an objection to the probate of the second will under which his minor ward inherited, and as guardian joined in

his wife's petition to probate the first will, under which she was the primary legatee.

A family settlement agreement was rapidly negotiated between Matthew's widow and Petitioner under the terms of which the widow received a cash payment and real estate in consideration for the widow's agreement to probate the first will and to surrender all her interest in the estate. By providing for probate of the first will, the settlement agreement disinherited Petitioner's minor son, Henry Warda. The settlement agreement was signed on behalf of the minor by the Petitioner's husband, although he had no prior court approval to do so. Throughout the proceedings, Petitioner's own attorney also acted as the minor's attorney. The minor received no consideration whatsoever under the terms of the family settlement agreement in exchange

for abandoning his claim to the entire residual estate under the second will.

When court approval for the settlement was belatedly sought in 1953, it was given as a matter of course upon the representation of the minor's guardian and attorney that the settlement was in the best interest of the minor, despite the absence of any financial consideration for the minor. No hearing or independent judicial investigation preceded the court's "rubber stamp" order approving the settlement. At the time of approval, the probate court had been misinformed that the estate amounted to only $50,000, rather than $247,000, as later revealed in the inventory.

Commencing in 1962, when Henry J. Warda became financially able to manage his grandfather's properties, and because of Petitioner's constructive trust obligation to him,

Petitioner began to transfer the properties to her son. No gift taxes were paid on the transfers.

The Commissioner thereafter claimed that those transfers gave rise to Petitioner's liability for gift taxes, penalties and interest. After a deficiency notice was issued, the tax payer filed a petition in the United States Tax Court. The Petitioner and her son also sought to reopen the Matthews Estate in the Berrien County probate court for the purpose of seeking recognition of a constructive trust. The Commissioner was served with process in the recent probate court proceeding and made a filing with the probate court on the eve of trial in the Tax Court which opposed the granting of relief.

After trial was conducted in the Tax Court, the Tax Court withheld its ruling for

more than thirteen months while it awaited a decision from the Probate Court as to Petitioner's status as a constructive trustee. On January 22, 1992, with no decision yet forthcoming from the Probate Court, the Tax Court handed down its own Opinion. The final Decision of the Tax Court was entered September 14, 1992.

The Tax Court's Opinion declined to independently consider the merits of Petitioner's claim that she took title to the land inherited from her father as a constructive trustee for the benefit of her son. The Tax Court ruled that:

> (i) "Deference" must be given to the pronouncement of a Michigan court regarding Michigan property law;
>
> (ii) The only pronouncement then in effect by a Michigan court regarding the inheritance was the original 1953 probate order vesting

> legal title to the inheritance in Petitioner;
>
> (iii) Petitioner's constructive trust claim was still pending before the Probate Court, and "no disposition of this matter by the probate court has been made."

On that basis, the Tax Court concluded that Petitioner's transfers of the inherited land to her son were taxable gifts, and upheld the Commissioner's assessments of gift tax deficiencies and penalties.

Shortly thereafter, on December 4, 1992, the Berrien County Probate Court entered a *Judgment Imposing Constructive Trust Upon Inheritance of Ethel M. Warda, As Constructive Trustee, For The Benefit Of Henry J. Warda, As Constructive Beneficiary.* The judgment included an explicit finding of fact that the Commissioner has subjected himself to the jurisdiction of the probate court and had become a party to the proceeding therein.

On appeal of the Tax Court Decision to the Circuit Court of Appeals, it was Petitioner's claim that:

(a) the 1992 Judgment of the Berrien County probate court was preclusive between the parties as to the constructive trust claim and issue; and

(b) in the alternative, the federal courts should conduct an independent analysis of Michigan constructive trust law, and adopt the reasoning and conclusions of the probate court because its judgment correctly applied Michigan law as enunciated by the Michigan Supreme Court.

The Court of Appeals held that the basis for the Tax Court rejection of Petitioner's constructive trust claim was "not clear." Nevertheless, the Court of Appeals affirmed the Tax Court on the ground of judicial estoppel,

which the Court of Appeals raised sua sponte. The court below reasoned that because Petitioner advocated probating the first will during the 1953 probate proceeding which resulted in a settlement under which the first will was probated (albeit, with concessions to the widow), Petitioner was judicially estopped from later claiming that her status was merely that of a constructive trustee. In the alternative, the Court of Appeals held that no constructive trust arose under Michigan law.

REASONS FOR GRANTING THE WRIT

Judicial Estoppel

Neither of the parties hereto argued the application of judicial estoppel,[2] either in the

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2 The most widely quoted statement of the doctrine, as applied by those federal circuits which do recognize the doctrine, is found in *Johnson Serv Co v TransAmerica Ins Co*, 485 F2d 164, 175 (5th Cir 1973): "Judicial estoppel is a technical rule designed to meet needs of broad public policy. It is directed against those who would attempt to (fn. cont.'d)

Tax Court or in the Court of Appeals. Nonetheless, the court below resolved this case by application of that doctrine. Fairness demands an opportunity for an adversely affected party to present views regarding a dispositive issue, such as judicial estoppel, that an appellate courts raises sua sponte.

Not all federal circuits recognize the doctrine of judicial estoppel. Those that do recognize the doctrine impose strict requirements which were not satisfied in the instant case.

The United States Court of Appeals for the Tenth Circuit has expressly *rejected* any application of the doctrine on the grounds that

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manipulate the court system through the calculated assertion of divergent sworn positions in judicial proceedings. Because the rule looks toward cold manipulation and not an unthinking or confused blunder, it has never been applied where plaintiff's assertions were based on...inadvertence or mistake."

it is better to vindicate public policy regarding the integrity of the courts by other means, allowing each lawsuit to attempt to reach the truth. *U.S. v 49.01 Acres of Land*, 802 F2d 387, 390 (10th Cir 1986). See also, *Parkinson v California Co*, 233 F2d 432, 437-438 (10th Cir 1956).

The doctrine is also of questionable validity in the Second Circuit. *Universal City Studios v Nintendo Co*, 578 F Supp 911, 920-921 (DCNY 1983), judgment affirmed, 746 F2d 112 (2nd Cir 1984). Although 100 years ago the Supreme Court held that protection of the court system's integrity is a "wise and salutary doctrine" (*Sturm v Boker*, 150 US 312; 14 S Ct 99; 37 L Ed 1093, 1101-1103 (1893)), this Court has never, itself, applied the doctrine of judicial estoppel.

Under prior rulings by other federal circuits and, indeed, by the Sixth Circuit itself, the technical rule of judicial estoppel should *not* be applied to peremptorily terminate litigation unless *all* of the following criteria are satisfied:

> (i) the prior assertion was one of fact, and not merely an opinion or a conclusion of law based upon uncontested facts;
>
> (ii) the prior assertion of fact was not the result of inadvertence or mistake;
>
> (iii) the prior judicial tribunal actually accepted the truth of the asserted fact after deliberation, and did not merely "rubber stamp" a settlement agreement independently reached between the parties; and
>
> (iv) the matter as to which the party currently seeks to assert a position must have been in existence at the time of the original proceeding, rather than a subsequent matter.[3]

3 The same four criteria are required under Michigan law: (i) the prior assertion must be "fact specific" (*Paschke v Retool Ind* (On Reh), 198 Mich App 702, 707; 499 NW2d 453 (1993) and "unequivocal" (*Lichon v American Universal Ins Co*, 435 Mich 408, 416; 459 NW2d 288 (1990)); (ii) the (fn. cont.'d)

In the instant case, *none* of the foregoing criteria are satisfied. Accordingly, the application of the doctrine in this case creates a conflict among even those circuits which recognize judicial estoppel.

First, the party against whom judicial estoppel is asserted must have advocated "inconsistent *facts*." *Scarano v Central R Co of New Jersey*, 203 F2d 510 (3rd Cir 1953). This Court itself refused to apply judicial estoppel where the party against whom the judicial estoppel was claimed merely advocated a conclusion of law based upon agreed facts, as opposed to having advocating a contested issue

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prior assertion must not be the result of mistake (*Paschke, supra*); (iii) there must be actual judicial acceptance of the fact, and not just a settlement (*Michigan Gas Utilities v Public Service Commission*, 200 Mich App 576; 505 NW2d 27 (1993); and (iv) judicial estoppel "does not penalize a [party] on the basis of information that only belatedly contradicts a factual claim (*Paschke, supra*, at 7070).

of fact which was then adopted by the first court. *Sturm v Boker, supra*, 37 L Ed at 1101-1103.

In the instant case, there was no contested issue of fact which the Petitioner advocated in the original 1953 proceeding that she now seeks to contradict. In the original proceeding Petitioner merely filed the first will for probate. Without filing any further pleadings containing factual claims or presenting any factual testimony, a settlement was reached allowing the first will to be probated contingent upon the widow receiving additional cash and real estate. Presently, Petitioner maintains that the totality of circumstances surrounding the *probating* of the first will (rather than any facts establishing invalidity of the first will) resulted in her obtaining legal title to her father's inheritance subject to a constructive trust for

the benefit of her son. There exists no *factual* contradiction to be prevented by application of judicial estoppel. Accordingly, the first criteria for application of judicial estoppel is not satisfied.

Second, judicial estoppel may not be applied if the previously advocated factual claim was the result of a mistake or inadvertence. *Konstantinidis v Chen*, 626 F2d 933, 939 (DC Cir 1980) and *Johnson Serv. Co v TransAmerica Ins Co*, 485 F2d 164, 175 (5th Cir 1973). The reasoning is that if the previously claimed fact resulted from misinformation, then the danger to the integrity of the courts created by allowing a party to change their claim is reversed, because a strict rule of judicial estoppel would force the court to continue to adopt a false position. "As with other principles of fairness, care must be taken that this approach not lead

to undue moralizing that may overlook reasonable grounds for changing positions on the basis of new information." Wright, Miller & Cooper, 18 *Federal Practice and Procedure*, Sec 4477 at 783 (1981).

In the instant case, the uncontested evidence in the Tax Court was that Petitioner's only purpose in opposing the second will was so that she (rather than the trustee named under the second will) would administer the farms until her son was financial ready to assume the responsibility in his own name. That evidence also established that Petitioner had been led to believe by her attorney (who stood to personally profit as executor under the first will), that probating the first will would only result in preventing the unwanted trustee from taking over control of the farms, but would not prevent Petitioner's son from claiming an equitable

interest in the property. Even if, arguendo, Petitioner had made a factual claim in the original probate proceeding which was accepted by the court in 1953 (which was not the case since no contested factual claim was ever made), that claim would have been the result of mistake and inadvertence. Accordingly, the second criteria for application of judicial estoppel is not satisfied.

Third, even the decision below, citing *Teledyne Indus v National Labor Relations Bd*, 911 F2d 1214, 1219 (6th Cir 1990), recognized the rule that judicial estoppel does not normally arise from a mere settlement agreement. This is so because a court order, entered to reflect a settlement independently reached by the parties, does not normally establish that the court "accepted" any fact originally advocated by a party. Thus, subsequent disavowal of an

earlier factual claim cannot impugn the integrity of a court which never actually accepted it. The court below attempted to avoid this exception to judicial estoppel by observing that the 1953 probate court, prior to approving the settlement which involved Petitioner's minor son, was required to independently find that the settlement was just and equitable.

In the instant case however, the recent 1992 probate court judgment was "harshly critical of the 1953 court's discharge of its duties." Indeed, the 1992 probate judgment determined, inter alia, that the original probate court utterly failed to conduct any independent consideration whatsoever of the settlement, and merely "rubber-stamped" an agreement involving fiduciaries which was so tainted by conflicts of interest that it was void on its face. Under these circumstances, where the

successor to the very probate court which originally approved the 1953 settlement subsequently held that its predecessor, on the face of the record, had failed to independently consider the provisions of the settlement agreement, it cannot be said that the original court ever "accepted" any claim made by Petitioner. Because the 1953 probate court utterly failed in its duty to actually consider the settlement terms, application of judicial estoppel so as to preserve that court's "integrity" is analogous to closing the barn door after the horse has already escaped. Accordingly, the third criteria for application of judicial estoppel is not satisfied.

Fourth and finally, superficial inconsistency must not be allowed to obscure underlying consistency. This is particularly true where the new claim relates to factual matters

that did not form the basis for the original determination, and the subject matter of the former and latter suits are different. *Himel v Continental Ill Nat Bank & Trust Co*, 596 F2d 205, 210-211 (7th Cir 1979). See also, *In re Johnson*, 518 Fed 246 (10th Cir 1975), where a decision applying judicial estoppel was reversed because the "subject matter" of the first action was different than the second.

In *Himel*, as in the instant case, plaintiffs raised issues relating to breach of fiduciary duty, only to have the district count find that such a claim would be barred by judicial estoppel. On appeal, the Seventh Circuit rejected application of judicial estoppel because the original court had not been requested to even consider the breach of fiduciary duty issue.

The *Himel* plaintiffs originally filed a state court action in 1961 against their trustee,

Continental Bank, seeking modification of the investment clause of a testamentary trust on the ground that adherence to the investment instructions had caused and would continue to cause the value of the trust to decline. The state court accepted that factual assertion and granted modification. Eleven years later, the plaintiffs brought suit against the Bank in federal district court claiming that breaches of fiduciary duty had caused the value of the trust to decline both before and after 1961. In reversing the district court and rejecting the defense of judicial estoppel, the Seventh Circuit stated:

> The doctrine is not applicable here because...the facts here are not "the same facts" in the first suit. Nor is plaintiffs' position here inconsistent with the position previously taken....Existence of one cause would not

> preclude relief based on another cause unknown in 1961. [596 F2d at 211.]

In the instant case, the facts relied upon by Petitioner to establish her status as a constructive trustee in the 1992 probate litigation and in the present tax litigation are unrelated to the legal principals which would have been relied upon by her in the original 1953 probate proceeding had there been no settlement agreement. In the original probate proceeding Petitioner claimed that, as a matter of law, the codicil to the previously revoked first will revived that will and by implication revoked the intermediate second will. There is *no* inconsistency whatsoever between Petitioner's original opinion regarding the law applicable to will revivals and revocations, based upon the undisputed facts in 1953, and the present claim that the circumstances surrounding final

approval of the settlement agreement created a constructive trust for the benefit of her son. Accordingly, the forth and last criteria for application of judicial estoppel is not satisfied.

Because *none* of the four prerequisites for application of judicial estoppel, imposed by those federal circuit which recognize judicial estoppel, are present in the instant case, Petitioner's petition to probate the first will in 1953, resulting in a settlement, does not preclude relief today based upon a constructive trust theory. If certiorari is not granted herein, the decision below will create a conflict between even those circuits which do recognize judicial estoppel.

Michigan Constructive Trust

The court below held that even if it were to have reached the merits of Petitioner's constructive trust claim, it would have still

denied relief. As its alternative holding, the court below ruled that, "the record [of the 1953 probate proceeding] simply does not indicate that Mrs. Warda's improper conduct had any effect on the probate court's decision to adopt Mrs. Warda's legal argument;" and even if such a causal link had been established, "equity does not require intervention at this late date."

In the case at bar, the reasoning and conclusions of the court below are inconsistent with prior decisions reached by the Michigan Supreme Court. In contrast, the reasoning and conclusions of Berrien County Probate Court, set forth in its judgment of December 4, 1992, are persuasive. They correctly reflect Michigan constructive trust law as enunciated by the Michigan Supreme Court.

Based upon the face of the original Probate Court record, the Probate Court found

that although Petitioner had no fraudulent intent, the original proceeding constituted constructive fraud against Petitioner's son, who was then a minor, citing the following four facts:

> (i) The minor's guardian breached the fiduciary duty owed to his ward;
>
> (ii) The minor's attorney breached the attorney - client duty owed to the minor;
>
> (iii) The minor received absolutely no consideration under the family settlement agreement; and
>
> (iv) The original probate judge failed to conduct an independent investigation as to the adequacy of the minor's settlement.

Applying well established Michigan law, as enunciated by the Michigan Supreme Court and Court of Appeals[4], the Berrien County Probate

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4 *Kent* v *Klein*, 352 Mich 652, 658; 91 NW2d 11 (1958), quoting *Stephenson* v *Golden*, 279 Mich 493; 272 NW 881 (1937), on rehearing 279 Mich 710, 740; 276 NW 849 (1937), quoting *Weir* v (fn. cont.'d)

Union Trust Co., 188 Mich 452, 463; 154 NW 357 (1915), Union Guardian Trust Co. v Emery, 292 Mich 394; 290 NW 841 (1940), Arndt v Vox, 83 Mich App 484, 452 (1976); 268 NW2d 693, citing Cerling v Hedstrom, 51 Mich App 338; 214 NW2d 904 (1974), Havens v Schoen, 108 Mich App 758; 310 NW2d 870 (1981), Grassman v Jelsema, 70 Mich App 745, 752; 246 NW2d 322 (1976), Reed & Hoyce v Muni Contractors, 106 Mich App 113, 120; 308 NW2d 445 (1981), Nelson v Woodworth, 363 Mich 244; 109 NW2d 876 (1961), Scarney v Clarke, 282 Mich 56; 275 NW 765 (1937), Mackey v Baker, 327 Mich 57, 66; 41 NW2d 331 (1950), Burton v Burton, 332 Mich 326; 51 NW2d 297 (1952), MacKenzie v Fritzinger, 370 Mich 284; 121 NW2d 410 (1963), Potter v Lindsay, 337 Mich 404; 60 NW2d 133 (1953), In re Valentino Estate, 128 Mich App 87, 94; 339 NW2d 698 (1983), Johnson v Loose, 201 Mich 259, 264; 167 NW 1021 (1918), Baxter v Trust & Savings Bank, 273 Mich 642, 647-648; 263 NW 762 (1935), In re Holley's Estate, 211 Ia 77; 232 NW 807 (1930), In re McClung's Estate, 267 Mich 309, 310; 255 NW 199 (1934), Farr v Whitefield, 322 Mich 275; 33 NW2d 791 (1943), In re Buckley's Estate, 330 Mich 102, 110; 47 NW2d 33 (1951), Damouth v Klock, 29 Mich 289, 296 (1874), Berdan v Milwaukee Mut. Life-Ins. Co., 136 Mich 396; 99 NW 411 (1904), Reliance Insurance Co. v Haney, 54 Mich App 237, 242-243; 220 NW2d 728 (1974), Friedman v Dozorc, 412 Mich 1,22; 312 NW2d 585 (1981), Hightower v Detroit Edison Co., 262 Mich 1,9; 247 NW 97 (1953), State Bar v Estes, 392 Mich 645, 651; 221 NW2d 322 (1974), In re Schlossberg, 388 Mich 389; 200 NW2d 219 (1972); People v Doyle, 159 Mich App 632; 406 NW2d 893 (1987), People v Gallagher, 116 Mich App 283; 323 NW2d 366 (1982); GAC Corp., v

(fn. cont.'d)

Court recognizes and imposes a constructive trust, for the benefit of Petitioner's son, upon all property inherited by Petitioner from her father's estate.

Mahoney Typographers, 66 Mich App 186; 238 NW2d 575 (1975), *Olitkowski* v *Loan Assn*, 302 Mich 303; 4 NW2d 664 (1942), *Matter of Grand Jury Proceedings*, 428 F Supp 273, 277 (ED Mich 1976), *Hay* v *LeBus*, 317 Mich 698; 27 NW2d 309 (1947), *In re Dodge Trust*, 121 Mich App 527, 539; 330 NW2d 72 (1982), *National Bank and Trust Company*, 267 Mich 270; 255 NW2d 587 (1934), *In re Blodgett's Estate*, 197 Mich 455; 163 NW 907 (1917), *In re Foulds' Will*, 21 Misc 2d 402; 196 NYS 2d 816, Aff'd 13 App Div 2d 16; 212 NYS 2d 519 (1961), *In re Trost*, 38 Misc 404; 77 NYS 879 (1902); and *Fuller* v *Nazal*, 259 Al 598; 67 So2d 806 (1953), *In re Marxhausen's Estate*, 247 Mich 192; 225 NW 632 (1929), *Centrala* v *Navrude*, 30 Mich App 30, 33; 186 NW2d 35 (1971), *Moebius* v *McKraken*, 261 Mich 404, 414, 246 NW 163 (1933), *Metzner* v *Newman*, 224 Mich 324, 330; 194 NW 1008 (1923), *Detroit Trust Co.*, v *Neubauer*, 325 Mich 319, 333; 38 NW2d 371 (1949), *Dudex* v *Sterling Brick Co.*, 237 Mich 470; 212 NW 92 (1927), *Palazzolo* v *Judge of the Supreme Court*, 234 Mich 547; 208 NW 677 (1926), *In re Bontea Estate*, 137 Mich App 374, 377; 358 NW2d 14 (1984), appeal denied, *Ryan* v *Chopp*, 314 Mich 255; 22 NW2d 363 (1946).

Rather then burden the Supreme Court by paraphrasing herein the probate court's exhaustive and well reasoned findings of fact and conclusions of law, Petitioner adopts and incorporates the probate judgment of December 4, 1992 as though set forth in full, and relies thereon in further support of her appeal.

CONCLUSION

For the foregoing reasons, Petitioner, Ethel M. Warda, respectfully prays that her Petition for a Writ of Certiorari be granted.

PETER J. JOHNSON
Counsel for Petitioner
800 Port St.,
P.O. Box 618
St. Joseph, MI 49085
(616) 982-1100

JAY L. SCHULTZ
Co-Counsel for Petitioner
816 Ship St.
St. Joseph, MI 49085
(616) 983-0151

RECOMMENDED FOR FULL-TEXT PUBLICATION
Pursuant to Sixth Circuit Rule 24

ELECTRONIC CITATION: 1994 FED App. 0020P (6th Cir.)
File Name: 94A0020P.06

No. 92-2344

UNITED STATES COURT OF APPEALS
FOR THE SIXTH CIRCUIT

ETHEL M. WARDA,
Petitioner-Appellant,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent-Appellee.

ON APPEAL from the United States Tax Court

Decided and Filed January 26, 1994

Before: NELSON and NORRIS, Circuit Judges; and HEYBURN, District Judge. *

JOHN G. HEYBURN II, District Judge. Petitioner Ethel Warda appeals the tax court's determination that certain conveyances of land from Mrs. Warda to her son were taxable gifts. This Court is faced with two Michigan

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*The Honorable John G. Heyburn II, United States District Judge for the Western District of Kentucky, sitting by designation.

probate court decisions, one from 1953 and another from 1992, each of which, if followed here, would produce completely different results. The 1953 probate ruling declared that Mrs. Warda held title to the property the Commissioner now wishes to tax; the 1992 ruling declared that Mrs. Warda had not held title to the land in question but held the property in constructive trust for the benefit of her son. We must determine whether the doctrines of res judicata or collateral estoppel grant conclusive effect to either probate decision and, if not, whether Mrs. Warda is nevertheless entitled to rely upon the 1992 probate ruling, which would bar the Commissioner from collecting the desired gift tax.

Although we approach this complex case differently than did the tax court, we agree with the tax court's result. Neither Michigan probate decision binds this Court under the circumstances. We hold instead, however, that Mrs. Warda is judicially estopped from disputing the result of the 1953 probate litigation, and we further hold that an independent review of the original probate proceedings does not support the retroactive imposition of a constructive trust. We therefore affirm.

I.

A.

Mrs. Warda's father, William Matthews, owned several parcels of Michigan land at his death in 1953. He had written two wills and a later codicil disposing of this property. The first will devised his land to Mrs. Warda; the second will revoked the earlier one and left the property instead to Mrs. Warda's son, Henry, the grandson of Mr. Matthews. Both wills also provided, in substantially identical terms, for monthly payments of support and medical assistance to Mr. Matthews' surviving wife. Some two years after he made his second will, Mr. Matthews executed a codicil which referred to and amended certain administrative provisions of the first will. The codicil did not expressly revoke, or even refer to, the second will. This ambiguity led to a will contest in 1953.

Mrs. Warda insisted during that litigation that her father's codicil impliedly revoked the second will and revived the first. Henry Warda, nineteen years old and represented by his father, who was the boy's legal guardian, responded that the second will should govern Mr. Matthews' estate. The Michigan courts had taken no clear position on that legal issue prior to 1953, and the question indeed remains unresolved to this day. (*See In re Estate of Matthews*, No. 17664, Berrien County, Mich. P.Ct. 1992.) More significant than the content of the parties' arguments, however, was the fact that Mrs. Warda and her son, though they had potentially conflicting interests in the litigation, were both represented by the same attorney. This conflict of interest, Mrs. Warda now argues, was a constructive fraud committed by Mrs. Warda against her son, one that tainted the entire probate proceedings.

The attorney for Mrs. Warda and Henry persuaded them to settle their differences through an agreement which would provide a lump-sum payment to Mr. Matthews' widow in lieu of lifetime support and then convey the rest of the estate to Mrs. Warda. Henry Warda's father petitioned the probate court to accept this settlement, suggesting that further litigation "would cause great expense and dissipate the assets [of the estate] and would be wholly unwarranted and unjust." That petition informed the court that "it is for the best interests of said estate and for the best interests of said minor [Henry Warda] that said settlement be made. . . ." The probate court adopted this view and authorized Henry Warda's father to enter the proposed settlement on Henry's behalf.

As the years passed, Mrs. Warda transferred virtually all of her father's land to Henry. Federal tax officials took note of these conveyances during an audit of Henry's finances. Henry Warda first contended that he had purchased these properties from his mother. Mrs. Warda substantiated her son's view of the transfers by sending a notarized letter to a revenue agent asserting that she had conveyed the parcels to Henry Warda as consideration for his work on the family farm. On advice of counsel,

however, Henry later recharacterized the transactions as gifts rather than sales. Mrs. Warda reversed herself, too, executing a series of affidavits in which she swore that the land transfers represented gifts to her son. When the government insisted that Mrs. Warda pay gift taxes on these transactions, however, Mrs. Warda again shifted ground, arguing that the transfers to Henry were either distributions from a constructive trust or ordinary sales.

The tax court rejected Mrs. Warda's constructive trust theory, summarizing its view in the following terms:

> [Mrs. Warda's] argument is based on the premise that her acquisition of the properties resulted from an erroneous decision of the Michigan probate court, i.e., petitioner should not have been granted a fee simple interest in the properties. We address petitioner's argument simply by stating that we defer to the Michigan probate court's [1953] order. The terms of the order speak for themselves: petitioner received a fee simple interest in the properties she inherited from her father.

The tax court accordingly determined that the land transfers were gifts from Mrs. Warda to her son, and were properly taxable as such. This appeal followed. 26 U.S.C. § 7482(a)(1).

B.

To complicate matters, Mrs. Warda began a parallel lawsuit in a Michigan probate court in October, 1990, even as her challenge was pending in the tax court. Mrs. Warda asked the Michigan court to declare that she had defrauded her son in the 1953 probate proceedings, and she petitioned the court to impose a constructive trust retroactively on all property she had taken under the original settlement.

This litigation attracted the attention of the district counsel for the Internal Revenue Service. That official, in a letter, informed the probate court that a similar action was pending before the tax court; the official also

forwarded several documents related to the federal litigation. The Commissioner did not otherwise participate in this Michigan probate litigation.

Mrs. Warda's most recent probate litigation ended successfully. In a decision rendered in 1992 after the tax court entered its ruling, the Michigan probate court declared that Mrs. Warda had defrauded her son of his rightful inheritance, and the court imposed a constructive trust stripping her of title to all property she had taken under the 1953 settlement.[1] The court stopped short of holding, as a matter of law, that Mr. Matthews' second will -- the one conveying his estate to Henry Warda -- was indeed the valid and enforceable will. The court observed, though, that Henry Warda's legal claim under the second will was at least not "insubstantial", despite the complicating presence of Mr. Matthews' later codicil.[2]

Mrs. Warda contends that the fraud she perpetrated against her son in 1953 prevents the tax court from basing

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[1]The probate court noted a series of "outrages" perpetrated against Henry Warda: the boy's father, though he acted as Henry's legal guardian, possessed contradictory personal interests arising from his marriage to Mrs. Warda; Henry Warda's attorney simultaneously represented Mrs. Warda, the boy's principal opponent in the 1953 litigation, and therefore suffered an even graver conflict of interest; and the 1953 probate court failed in its duty to protect a minor like Henry Warda from his mother's wrongdoing.

[2]It is highly ironic that the 1990-1992 proceedings, which Mrs. Warda brought to redress conflicts of interest occurring in the original probate, were themselves marred by an apparent conflict of interest. The same attorney represented both Mrs. Warda and her son in the 1990 action, even though by all appearances they were opposing parties in that litigation. This irony gives rise to the broader concerns about the 1990-1992 proceedings in which the record suggests that no adverse litigant participated in that lawsuit, no hearings took place, and no evidence or argument was offered in support of the original probate proceedings.

its decision on the result of those tainted proceedings. She argues specifically that the doctrines of res judicata and collateral estoppel do not assign preclusive effect to the 1953 probate decree. By her view, though, the same preclusion doctrines do require this Court to defer to the result of the 1990 probate litigation. Even if we are not bound by those recent proceedings and must conduct an independent review of the 1953 litigation, Mrs. Warda continues, the later probate court's sound reasoning should lead us to an identical conclusion.

II.

Whether a taxpayer holds an interest in property, and the nature of that interest, is determined by reference to state law. *Aquilino v. United States*, 363 U.S. 509, 513 (1960). Mrs. Warda's title to the property she transferred to her son traces back to the 1953 probate court decree. Where, as here, the judgment of a state probate court bears on a taxpayer's rights in property, that judgment is entitled to the same deference in federal court as it would receive under the law of that state. U.S. Const., art. IV, § 1 (Full Faith and Credit Clause); 28 U.S.C. § 1738; *Migra v. Warren City Sch. Dist.*, 465 U.S. 75, 80-81 (1984). We accordingly must determine whether, under Michigan law, the principles of *res judicata* make the 1953 order of the probate court conclusive with respect to Mrs. Warda's title. We conclude that the 1953 ruling is not entitled to such binding effect.

The doctrine of res judicata, now more commonly called claim preclusion, assures that an original cause of action is extinguished by a judgment, regardless of the particular issues raised and litigated in the action. *Howell v. Vito's Trucking & Excavating Co.*, 191 N.W.2d 313, 315 (Mich. 1971). Under Michigan law, then, a plaintiff cannot maintain a subsequent lawsuit against a defendant based upon the same cause of action determined by the original judgment. *Id.* The cause of action between the parties to the present lawsuit -- Mrs. Warda's purported liability for the payment of gift taxes -- is not the same cause of action

determined by the litigation before the Michigan probate court in 1953. Nor is the cause of action contested here identical to the claim decided by the probate litigation begun by Mrs. Warda in 1992. Thus the 1953 probate order does not bar Mrs. Warda from disputing her tax liability today; nor could the result of the more recent probate litigation preclude the Commissioner from seeking to impose the desired gift tax.

The doctrine of collateral estoppel, now better known as issue preclusion, holds that a judgment is "conclusive between the parties . . . as to questions actually litigated and determined by the judgment." *Howell*, 191 N.W.2d at 315. Mrs. Warda's rightful claim to certain parcels of land was clearly at issue in both the 1953 and 1992 probate court proceedings; the same issue also figures largely in the tax court's judgment currently under review. Under appropriate circumstances, then, the 1953 probate decree might preclude Mrs. Warda from relitigating the issue of whether she held title to the land she transferred to her son; by the same token, the judgment of the 1992 probate court stripping Mrs. Warda of her title might, where appropriate, bar the Commissioner from contending that Mrs. Warda owned the land at issue.

Neither result is appropriate in this litigation, however, due to the Michigan rule of mutuality. Where a party attempts offensive use of a previously litigated issue, Michigan law will give preclusive effect to the prior determination only between those who were parties or their privies to the previous suit. *Howell*, 191 N.W.2d at 318; *Knoblauch v. Kenyon*, 415 N.W.2d 286, 290 (Mich. Ct. App. 1987). Collateral estoppel is inapplicable. *Id.* at 317; *Lichon v. American Universal Ins. Co.*, 459 N.W.2d 288, 298 (Mich. 1990). In the case before us, each party seeks to use a Michigan probate ruling as an offensive weapon against the other. *Lichon*, 459 N.W.2d at 297-98. Because of the lack of mutuality between Mrs. Warda and the Commissioner, neither lawsuit precludes the parties from

litigating the nature of Mrs. Warda's interest in the land she transferred to her son.[3]

III.

Although neither res judicata nor collateral estoppel apply directly, we cannot ignore the previous two state lawsuits, especially the 1953 probate action. Under the instant circumstances we believe that the doctrine of judicial estoppel mandates that the 1953 decree is conclusive and precludes Mrs. Warda from challenging that decree.

Judicial estoppel forbids a party from taking a position inconsistent with one successfully and unequivocally asserted by that same party in an earlier proceeding. *Teledyne Indus. v. National Labor Relations Bd.*, 911 F.2d 1214, 1217 (6th Cir. 1990); *Reynolds v. Commissioner of Internal Revenue*, 861 F.2d 469, 472 (6th Cir. 1988); *Edwards v. Aetna Life Ins. Co.*, 690 F.2d 595, 598 (6th Cir. 1982).[4] This doctrine "preserves the integrity of the courts by preventing a party from abusing the judicial

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[3]It is true that in 1992 the Michigan probate court believed the Commissioner to be an "interested party" who had been served with notice of the action and had appeared in the probate litigation by virtue of the letter described above. (*In re Estate of Matthews*, No. 17664 at *3, ¶ 1.) But the Commissioner was not a "creditor" of Mr. Matthews' estate as defined by Michigan law, nor did the Commissioner otherwise hold property rights in that estate. Mich. Comp. Laws Ann. § 700.7(4).

[4]Federal standards govern the application of judicial estoppel in federal court. *Edwards*, 690 F.2d at 598, n.4. This is because the doctrine is designed to protect the integrity of judicial institutions, and because the question (when presented in federal court) primarily concerns federal interests. *Id.* The courts of Michigan have defined their judicial estoppel doctrine in terms that are virtually identical to those used in the Sixth Circuit, however, and we feel confident that the result we reach under federal law would be achieved with equal dispatch under Michigan law. *See, e.g., Lichon*, 459 N.W.2d at 293 *and Michigan Gas Util. v. Public Serv. Comm'n*, 505 N.W.2d 27, 31 (Mich. Ct. App. 1993).

process through cynical gamesmanship, achieving success on one position, then arguing the opposite to suit an exigency of the moment." *Teledyne*, 911 F.2d at 1218. Mrs. Warda attempts to do precisely this in the current litigation. In 1953 she persuaded the probate court that title to her father's land was rightfully hers; now she attempts to persuade this Court that title to that land properly rests in her son, Henry Warda. The judicial estoppel doctrine addresses and attempts to prevent this sort of inconsistency.

Judicial estoppel applies when a party "took a contrary position under oath in a prior proceeding" and this earlier position "was accepted by the court." *Teledyne*, 911 F.2d at 1218. The doctrine does not require a finding that an opponent relied on the position taken by the party in the earlier litigation, and it does not require a showing of mutuality. *Id.* at 1220. It does mandate a finding of "judicial acceptance", however: judicial estoppel governs a dispute only if the first court "adopted the position urged by the party, either as a preliminary matter or as part of a final disposition." *Id.* at 1218. The issue we must decide, then, is whether the probate court in 1953 endorsed Mrs. Warda's legal position when it approved the settlement she offered during that litigation. We think that it did.

It is true that a settlement, even in the form of an agreed order, usually does not constitute judicial acceptance of the terms the settlement contains. *Teledyne*, 911 F.2d at 1219; *Reynolds*, 861 F.2d at 473. But the approval of a settlement satisfies the judicial acceptance requirement when the court is obliged to ensure that the settlement is fair and equitable, *Teledyne*, 911 F.2d at 1219, and when the court cannot discharge its duties by acting as "a mere rubber stamp", *Reynolds*, 861 F.2d at 473. Thus, for example, judicial acceptance occurs in the context of a bankruptcy settlement when the court approves a payment from the bankruptcy estate on the basis of a party's assertion of a given position. *Reynolds*, 861 F.2d at 473. The similarity between the approval of a bankruptcy settlement and the action of the Michigan probate court

forty years ago suggests that judicial acceptance occurred in this case in 1953.

There seems little doubt that the probate court in 1953 approved the parties' settlement in large part on the strength of Mrs. Warda's claim that only the codicil and the first will were legally valid. Mrs. Warda, her husband, and her attorney emphasized this position throughout the 1953 proceedings. The probate court acknowledged the soundness of this legal argument when it permitted Henry Warda's father to join the settlement on the boy's behalf. Mrs. Warda's legal position became all the more important in light of the probate court's twin duties to assure that a good faith controversy existed regarding the efficacy of the two wills and that the settlement was just and reasonable with respect to Henry's interests. *In re Marxhausen's Estate*, 225 N.W. 632, 634 (Mich. 1929).[5]

Mrs. Warda now wishes to argue that she was not entitled to inherit her father's land. But it is too late in the day for Mrs. Warda to advance her new theory. She inherited substantial wealth many years ago, and she

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[5]The probate court which reopened Mr. Matthews' estate in 1990 was harshly critical of the 1953 court's discharge of its duties. It does appear that the 1953 court ignored, or at least failed to identify, conflicts of interest affecting Henry Warda's attorney and legal guardian. The crucial issue, though, is whether the court endorsed Mrs. Warda's legal argument regarding the first will's validity when the court approved the probate settlement. That the 1953 court indeed depended on this legal position cannot be doubted. The *correctness* of Mrs. Warda's original legal argument remains a matter of some dispute, though the later probate court declined to resolve the matter once and for all. But the possibility that the 1953 court might have been wrong in its estimation of Michigan law need not concern us. The focus of judicial estoppel is not on the correctness of an earlier court's ruling or on the truthfulness of the argument made by a party originally; the doctrine instead "precludes a contradictory position without examining the truth of either statement." *Teledyne*, 911 F.2d at 1218. The issue, then, is not whether the 1953 court was *correct* in its acceptance of Mrs. Warda's legal position, but whether the court accepted that argument at all.

benefited from the ownership of that property for many years as a result of the 1953 probate court's acceptance of her original theory. She cannot prevail again by arguing the opposite in court now. We recently noted the incongruity of allowing a litigant to defeat her own actions by attacking the validity of a settlement that she had willingly procured, and we refused to grant the litigant relief based upon her own bad acts. *See In re Green*, No. 91-6204 at *5, *10 (6th Cir. 1993). We will not permit Mrs. Warda to accomplish the same result. Her efforts represent a "knowing assault on the integrity of the judicial system", *Reynolds*, 861 F.2d at 474, and, under the doctrine of judicial estoppel, that assault must fail.[6]

IV.

We would not reach a different result if we resolved this litigation on the merits of Mrs. Warda's constructive trust argument. We note, first, that Mrs. Warda has shown no causal link between the attorney's conflict of interest and the 1953 probate court's approval of the settlement by which she inherited her father's land. Mrs. Warda's success in 1953 depended on the probate court's acceptance of her legal argument that the codicil to Mr. Matthews' first will impliedly revoked the second will and revived the first instrument. The strength of this legal argument remains untested to this day; even the Michigan probate court in 1990, though otherwise unstinting in its criticism of its 1953 predecessor, refused to declare that the 1953

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[6] It is not clear whether the tax court based its ruling on a correct application of the judicial estoppel doctrine, or relied instead on a misunderstanding of claim or issue preclusion rules, or chose still another foundation for its decision. We need not investigate this matter, however; an appellate court may affirm on any ground supported by the record, even though the ground relied on by the lower court was different from the one chosen by the appellate panel. *United States v. American Railway Express Co.*, 265 U.S. 425, 435 (1924); *Hilliard v. United States Postal Serv.*, 814 F.2d 325, 326 (6th Cir. 1987).

court was legally wrong in finding the first will valid. (*In re Estate of Matthews*, at *18-20, ¶ 31.)

The record therefore simply does not indicate that Mrs. Warda's improper conduct had any effect on the probate court's decision to adopt Mrs. Warda's legal argument, and it certainly cannot be contended that the legal argument itself was fraudulent. Henry Warda did not have an irrefutable right to his grandfather's estate under the second will. He held, at best, a "not insubstantial" claim to his grandfather's estate. (*See In re Estate of Matthews* at *20, ¶ 31.) His mother held no less. Under even the best of circumstances, then, Henry Warda could have emerged from the 1953 probate with nothing. As it happened, he fared better under the 1953 settlement than he might have otherwise; Henry Warda himself has suggested that his parents pursued the settlement in part to prevent Mr. Matthews' estate from falling under the exclusive control of Mr. Matthews' wife and his trustee. At the time, this result appeared to be highly beneficial for both Henry Warda and his mother. We, therefore, doubt the soundness of imposing *ex post facto* a constructive trust on Mrs. Warda without first determining that she inherited her father's land on the basis of her fraudulent acts. *Hudson v. Hudson*, 108 N.W.2d 902, 905 (Mich. 1961).

Even if we accept that the taint upon the 1953 proceedings contributed to Henry Warda's disinheritance, equity does not require intervention at this late date. Henry Warda has not lacked the opportunity or wherewithal to remedy any harm his mother caused him during the 1953 proceedings. He reached his majority before his grandfather's estate was closed,[7] and he learned the details of the will contest and resulting settlement by that time or soon thereafter. He nevertheless chose not to challenge his mother's conduct until Mrs. Warda's many gifts to her son forced the probate court in 1992 to impose

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[7] Henry Warda was born on April 18, 1934. He was over 21 years of age when his grandfather's estate was closed on July 11, 1955.

a singularly curious constructive trust, one that did not even purport to remove wrongfully withheld property from Mrs. Warda, so that the property could vest in Henry Warda. The probate court could not do this, presumably because Henry Warda already was the outright owner of his grandfather's estate. In essence, the most recent probate action merely "cooked the records" pertaining to Mr. Matthews' former estate, making mere bookkeeping changes rather than altering the status quo. Whatever wrong was done to Henry Warda, if any, does not mandate the rejection of a tax liability properly assessed against Mrs. Warda in order to remedy any slight suffered by Henry Warda four decades past.

V.

We hold that the doctrine of judicial estoppel precludes Mrs. Warda from denying the validity of the 1953 probate settlement which made her the heir to her father's estate. We hold further that Mrs. Warda has failed to establish that the probate court's acceptance of this settlement was prompted by her own wrongful acts such that a constructive trust should be imposed on the lands she inherited under the agreement. We therefore **AFFIRM** the decision of the United States Tax Court.

STATE OF MICHIGAN

PROBATE COURT FOR THE COUNTY OF BERRIEN

File No. 17664
HON. W. SCHILLINGER

In the Matter of the

ESTATE OF WILLIAM H. MATTHEWS,

Deceased

PETER J. JOHNSON (P15539)
JAY L.SCHULTZ (P41022)
Attorneys for Petitioners
800 Port Street, P.O. 618
St. Joseph, MI 49085
(616) 982-1100

JAMES F. MAURO(P39960)
District Counsel
Internal Revenue Service
678 Front Street, N.W
Grand Rapids, MI 49504
(616) 235-0340

JUDGMENT IMPOSING CONSTRUCTIVE TRUST UPON INHERITANCE OF ETHEL M. WARDA. AS CONTRUCTIVE TRUSTEE FOR THE BENEFIT OF HENRY J. WARDA. AS CONSTURCTIVE BENEFICIARY

AT A SESSION OF THE PROBATE COURT HELD AT THE COURTHOUSE IN THE CITY OF ST. JOSEPH, COUNTY OF BERRIEN, STATE OF MICHIGAN ON THE ___ DAY OF DECEMBER, 1992, BEFORE THE HON. WILBUR SCHILLINGER, PROBATE JUDGE.

THIS MATTER Having Come before the Court upon a Second Amended Petition to Reopen Estate Proceedings herein and a Petition to Modify the Settlement Order of 1953 to Protect the Interest of Henry J. Warda, which petitions were filed by Ethel M. Warda and Henry J. Warda, and having before it all interested parties, including the Commissioner of Internal Revenue, who received notice of this proceeding and who appeared herein by virtue of a filing made with this Court by

District Counsel for Commissioner on November 14, 1990, which filing opposed granting the relief prayed for by Petitioners herein, having given due consideration to such filing by the Commissioner, and further having had the benefit of considering the Opinion and Decision of the United States Tax Court in the matter of Ethel M. Warda v. Commissioner of Internal Revenue, U.S. Tax Court Docket No. 23134-89, T.C. Memo. 1992-43, which Opinion declined to consider whether Ethel M. Warda's inheritance from decedent herein, William H. Matthews, was subject to a constructive trust for the benefit of her son, Henry J. Warda, holding instead that, "deference...must be given [by the United States Tax Court] to [the original probate court] orders" (Opinion, footnote 3 at p.

9), and which Opinion further took notice of the fact that as of the date of issuance of the Tax Court Opinion (January 22, 1992) the Probate Court in and for the County of Berrien, State of Michigan, had made "no disposition" of the constructive trust claim (Opinion, footnote 1 at p. 3), and having further had the benefit of considering the briefs filed in the Tax Court by Ethel M. Warda and by the Commissioner, and being otherwise fully advised in the premises.

IT IS HEREBY ORDERED AND ADJUDGED That all of the material facts necessary to rule upon the petitions herein are set forth on the face of the probate record herein as well as on the face of the probate record of In the Matter of the Estate of Henry J. Warda, Minor, Probate

Court File No. 13476, and accordingly no evidentiary hearing is required.

IT IS FURTHER ORDERED AND ADJUDGED That the following be, and hereby are, entered as the Findings of Fact and Conclusion of law made and arrived at by this Court:

FINDINGS OF FACT

1. This Court has before it all interested parties, being Ethel M. Warda, daughter of decedent, and Henry J. Warda, grandson of decedent, the only surviving heirs at law of decedent, who are Petitioners herein, as well as the Commissioner of Internal Revenue, who was identified as an interested party in the First and Second Amendment to Petition to Reopen Estate Proceedings filed herein, who was served with notice hereof, and who appeared herein by virtue of a filing made

herein by District Counsel for said Commissioner on November 14, 1990.

2. On September 25, 1950 William H. Matthews (then 82 years of age) married his second wife, Edith Carrington (then 67 years of age).

3. On October 2, 1950 William H. Matthews and his new wife executed post-nuptual agreements waiving their spousal interest in each other's estate.

4. On that same day William H. Matthews executed a will prepared by Attorney Casper R. Grathwohl (hereinafter "First Will"). Under that First Will the testator's daughter,

Ethel M. Warda, was to be appointed executrix. After providing for the care and maintenance of his widow, William H. Matthews left his entire estate, in fee simple absolute to Ethel M. Warda.

5. Two months later, on December 4, 1950, William H. Matthews executed a Second Will which was prepared by Attorney Thomas W. Cain, Jr. (hereinafter "Second Will"). Under the Second Will, Attorney Cain was appointed executor and trustee. The entire William H. Matthews estate was left to a trust which, after providing for the care and maintenance of his widow (substantially identical to her legacy under the First Will), granted to his daughter, Ethel M. Warda only a life estate in the income from the trust as well as use of the

family residence. Upon Ethel M. Warda's death, the trust was to be dissolved and the entire corpus distributed in fee simple absolute to Ethel M. Warda's then minor son, Henry J. Warda.

6. Between September and November, 1952 (while William H. Matthews was still alive) a minor's estate had been opened for Henry J. Warda in the Berrien County Probate Court.

7. The only purpose of the guardianship was to authorize the minor to sell an electric line easement with respect to a tract of land held jointly in his and his mother's names.

8. Anthony J. ("A. J.") Warda, Ethel M. Warda's husband, was appointed guardian and his sale of the easement for $165 was confirmed. The minor's estate

remained open thereafter only to administer the resulting $165 in proceeds.

9. On November 19, 1952 William H. Matthews went back to the office of Attorney Grathwohl and caused a testamentary codicil to be prepared which he then signed. The codicil had one operative provision: it nominated Grathwohl as executor. However, the pragmatic significance of the codicil was in its recital that it constituted a codicil to the First Will.

10. The codicil itself made no reference to revoking the intervening Second Will and reviving the previously revoked First Will. According to Attorney Grathwohl's own representation to the probate court, William H. Matthews never told Grathwohl that he wanted to utilize the codicil as a means of revoking the

Second Will and of reviving First Will. Grathwohl referenced the codicil to the First Will only because he did not know that the Second Will existed. 11. William H. Matthews (then 84 years of age) may have intended the codicil to do nothing more than to substitute Grathwohl in place of Cain as executor and trustee under the Second Will.

12. When William H. Matthews, father and grandfather, respectively, of Petitioners, Ethel M. Warda and Henry J. Warda, died in 1953, he left an estate valued at $247,000.

13. When William H. Matthews died on July 1, 1953, the stage had been set for a will contest. A will contest ensued involving the First Will, the Second Will revoking the First Will, and the

subsequent codicil to the revoked First Will. The subsequent codicil to the revoked First Will was drafted by a lawyer who did not know that the Second Will existed.

14. On July 2, 1953 Attorney Cain opened the William H. Matthews estate by filing a petition to probate the Second Will on behalf of the widow. On July 10, 1953 Attorney Grathwohl filed a petition to probate the First Will and the codicil on behalf of Ethel M. Warda.

15. The battle lines were thus drawn. Ethel M. Warda retained Attorney Grathwohl "for contest of will" and paid him an initial retainer of $7,500. His total fee for securing probate of the First Will eventually amounted to $25,000.

16. The widow of William H. Matthews retained Attorney Cain to represent her in

seeking to have the Second Will probated, even though her bequest was basically identical under both wills.

17. Michigan courts had never adjudicated the issue of whether a subsequent codicil to a revoked will served to revive the revoked will and to revoke the intervening will.

18. Attorney Grathwohl, in addition to representing Ethel M. Warda, also represented the minor's estate. Attorney Grathwohl represented both parties despite the diametrically opposed interests of Ethel M. Warda and her minor son.

19. In the will contest, the probate court neither appointed a guardian ad litem to represent Henry J. Warda, Ethel M. Warda's minor son, nor did it authorize independent legal counsel for the minor.

20. Without making any effort to have his letters of authority to act as guardian (originally issued only with respect to sale of an easement for $165) reissued with respect to the will contest, Ethel M. Warda's husband immediately commenced to act in the name of the minor with respect to the will contest in which his wife and ward had diametrically opposed interests.

21. The Ethel M. Warda's husband claimed authority to act for the minor in the will contest, even though he had only been appointed guardian with respect to the prior $165 easement matter.

22. On July 21, 1953 Attorney Grathwohl prepared a waiver of notice and consent to probate the First Will and codicil. He also prepared a written objection to the admission of the Second

Will and a petition to probate the First Will and codicil.

23. These documents, disavowing the minor's interest in the estate, were signed by A. J. Warda, as guardian of the minor. Attorney Grathwohl additionally signed the objection. The minor's guardian and attorney thereby sought to probate the very will which disinherited the minor in favor of the guardian's wife, Ethel M. Warda.

24. On July 25, 1953, following negotiations between Ethel M. Warda (represented by Attorney Grathwohl) and Matthew's widow (represent by Attorney Cain), the widow agreed that the Second Will would be held null and void and that the First Will would be probated. The widow also agreed to release all of her right, title and interest in the estate.

In exchange, the widow was to receive $20,000 in cash as well as valuable Florida real estate.

25. Under the terms of the settlement agreement Matthew's minor grandson, Henry J. Warda, was to receive no consideration whatsoever even though he would have inherited the entire residual estate had the Second Will been probated.

26. Nevertheless, Ethel M. Warda's husband, A. J. Warda, acting in the role of the minor's guardian, but without prior probate court approval, abandoned his ward's claim in favor of his wife's claim and signed the settlement agreement on behalf of the minor.

27. Throughout the course of the negotiations and probate court proceedings, Ethel M. Warda's attorney,

Grathwohl, simultaneously acted as the minor's attorney.

28. On August 6, 1953 A. J. Warda petitioned the probate court for approval of the settlement agreement previously signed by him as guardian. On the same day that the petition was filed, the probate court approved it as a matter of course upon the representation of the minor's guardian and attorney that the settlement was in the best interest of the minor -- despite the absence of any consideration for the minor.

29. The record reveals that the order was entered without any court hearing or independent judicial investigation. A.J. Warda never obtained reissuance of his letters of authority to act as guardian of the minor with respect to the will contest. Neither a guardian

ad litem, nor independent counsel was appointed for the benefit and protection of the minor. In addition, the parties misrepresented to the court the value of the estate: the claimed value was just $50,000, but after the settlement, an inventory was filed reflecting a true value of $247,000.

30. Based upon the settlement and by order of this Court dated August 4, 1954, the entire residue of decedent's estate, including all of his real estate holdings, was assigned to the residuary legatee and devisee of decedent under the First Will, Ethel M. Warda.

31. Commencing less than eight years later, in 1962, Ethel M. Warda began to transfer title to the lands inherited from her father to her then adult son, Henry J. Warda, and her son's wife.

CONCLUSIONS OF LAW

1. A constructive trust arises under Michigan Law whenever unjust enrichment results from wrongful acquisition.

2. Constructive trusts are not actual trusts. They are remedial devices which will be "raised by courts of equity whenever it becomes necessary to prevent a failure of justice." Kent v Klein, 352 Mich 652, 658; 91 NW2d 11 (1958), quoting Stephenson v Golden, 279 Mich 493; 272 NW 881 (1937), on rehearing 279 Mich 710, 740; 276 NW 849 (1937), quoting Weir v Union Trust Co., 188 Mich 452, 463; 154 NW 357 (1915). See also, Union Guardian Trust Co. v Emery, 292 Mich 394; 290 NW 841 (1940), Arndt v Vox, 83 Mich App 484,

452 (1976); 268 NW2d 693, citing Cerling v Hedstrom, 51 Mich App 338; 214 NW2d 904 (1974).

3. Michigan courts are required to go to any lengths in order to see through appearances and to find substance. Kent, supra, 352 Mich at 656. "The forms and varieties [of constructive trusts] are practically without limit" and the only factor which must always be present is "unjust enrichment". Kent, supra, 352 Mich at 657-658.

4. A party in whose favor a constructive trust is claimed need not have suffered actual loss. Id.

5. "The grounds which have traditionally been recognized as justifying the imposition of a constructive trust" (Havens v Schoen, 108 Mich App 758; 310 NW2d 870 (1981)) are

wrongful acquisitions of legal title to property by means of "breach of fiduciary or confidential relationship, misrepresentation, concealment, mistake, undue influence, duress or fraud." Grassman v Jelsema, 70 Mich App 745, 752; 246 NW2d 322 (1976), emphasis added. See also, Reed & Hoyce v Muni Contractors, 106 Mich App 113, 120; 308 NW2d 445 (1981).

6. So-called "actual" fraud" is not required. Nelson v Woodworth, 363 Mich 244; 109 NW2d 876 (1961). "Constructive fraud," meaning simply receipt or retention of unmerited benefits, is sufficient. Union Guarantee Trust Co., supra, and Scarney v Clarke, 282 Mich 56; 275 NW 765 (1937).

7. A preponderance of proof is all that is necessary in order to establish a constructive trust. Mackey v Baker, 327

Mich 57, 66; 41 NW2d 331 (1950). See also, Stephenson, supra.

8. Where enrichment is rendered unjust because the acquisition itself was tainted by wrongful conduct, there is no requirement that there have been any intention or agreement that the property be held for the benefit of another. Such "constructive trusts do not arise from agreement or from intention." Kent, supra, 352 Mich at 657. See, Arndt, supra, 83 Mich App at 487 and citations therein; see also, Grasman, supra, 70 Mich App at 752.

9. Ethel M. Warda was unjustly enriched as the result of a family settlement agreement which, on the very face of the probate record, violated Michigan law and constituted constructive

fraud as to her then minor son, Henry J. Warda.

10. The settlement was permeated by so many outrages against the minor that not a single safeguard built into Michigan law for the protection of minors functioned as intended.

11. Michigan courts have a long established and well respected history of holding settlements, contracts, and other transactions involving a fiduciary void or voidable, even decades after the fact, when improprieties far less egregious than those discussed below have been revealed. See, e.g., Nelson v Woodworth, supra, Burton v Burton, 332 Mich 326; 51 NW2d 297 (1952), and authorities discussed in MacKenzie v Fritzinger, 370 Mich 284; 121 NW2d 410 (1963). See also, Potter v Lindsay, 337 Mich 404; 60 NW2d 133 (1953).

12. Because Ethel M. Warda's acquisition of land from her father's estate was tainted by constructive fraud against the then minor, Henry J. Warda, a constructive trust arose in favor of Henry J. Warda at the time his mother, Ethel M. Warda, acquired legal title to the property.

13. Guardians are fiduciaries. In re Valentino Estate, 128 Mich App 87, 94; 339 NW2d 698 (1983). The first prerequisite for a binding minor's settlement is the appointment of a fiduciary free from potential conflicts of interests. The Michigan Supreme Court described the "sacred" relationship between the guardian of minors and his wards thusly:

> As such guardian he was charged with a

most sacred trust, a most sacred duty, that of guarding their interest for [his minor wards'] benefit and for their benefit alone. When a [minor's guardian] undertakes to manage for others he undertakes not to manage for his own benefit. He must not put himself in any position where his self interest may in the slightest degree have any tendency to conflict with the interest of the [ward] . . . . Courts of equity must be most vigilant in the protection of the [minor]. They must be constantly on guard to protect the interest of minor wards. As was remarked by Lord Eldon, in Hatch v Hatch, 9 Ves 292:

"If the court does not watch these transactions with a jealousy almost invincible, in a

> great majority of cases it will lend its assistance to fraud."
>
> It has, therefore, frequently been stated that not only is the rule designed to prevent fraud on the part of the [guardian], but also to prevent the temptation to commit fraud . . . .

Johnson v Loose, 201 Mich 259, 264; 167 NW 1021 (1918), emphasis added.

14. A.J. Warda occupied conflicting roles. His personal self-interest as husband of Ethel M. Warda was antagonistic to his duties as guardian. In Baxter v Trust & Savings Bank, 273 Mich 642, 647-648; 263 NW 762 (1935), the Michigan Supreme Court cited with approval a decision of the Iowa Supreme Court expressly prohibiting a fiduciary from

approving any transaction which involved the fiduciary's spouse. In re Holley's Estate, 211 Ia 77; 232 NW 807 (1930). A. J. Warda's approval, on behalf of his ward, of a settlement which allowed A. J. Warda's wife to inherit the land at his ward's expense directly violated Baxter v Trust & Savings Bank and In re Holley's Estate:

> As a rule, the husband or wife expects and realizes a pecuniary benefit, either directly or indirectly, from the property acquired by the other. . . . [I]t is held that the same doctrine which prohibits the trustee from selling to himself likewise prohibits the trustee form selling to his or her spouse. . . . However innocent the purchase may be in the given case, it is poisonous in its

consequence. . . The exclusion of the wife as a purchaser, where the husband sells as trustee, is not so much for the reason that he may subsequently become entitled to some interest in her lands, as on account of the unity which exists between them in the marriage relation. The case falls clearly within the spirit of the principle which excludes the husband himself. . . .. So jealous is the law of the interest of the cestui que trust, that it will not tolerate the slightest antagonism on the part of the trustee. The object of the rule is to prevent the trustee from using his information and power to the prejudice of the cestui que trust. . . .

232 NW at 810-811, citations omitted, emphasis added. When a trustee "act[s] in [a] dual capacity, he subject[s] himself to criticism and suspicion". In re McClung's Estate, 267 Mich 309, 310; 255 NW 199 (1934), emphasis added.

15. "As a matter of law the probate court was vested with power to control and charged with the duty to protect the minor's property interest. . . ." Farr v Whitefield, 322 Mich 275; 33 NW2d 791 (1943), emphasis added. To the same effect, see In re Buckley's Estate, 330 Mich 102, 110; 47 NW2d 33 (1951). In Farr, the Michigan Supreme Court was concerned that during a will contest involving the estate of a minor's mother, the minor's interests might not be adequately protected by his father, who had previously been appointed guardian ad

litem. The father was the divorced husband of the testatrix. Accordingly, the court appointed a bank as a general guardian, granted the bank authority to engage independent counsel, and subsequently "ordered that the [bank] guardian, be and hereby is directed to" contest the will. 322 Mich at 278. The personal interests of Ethel M. Warda's husband herein and of his minor ward were in direct conflict. The minor, Henry J. Warda, was entitled to the same protection as was the minor in Farr.

16. The Michigan Supreme Court has held that anyone in A. J. Warda's position of conflicting loyalty is categorically disqualified from disavowing a minor's property rights. An "outrage upon the infant and upon the administration of justice" existed and the "whole purpose

of creating [a guardianship] ha[d] been perverted", where a court appointed as guardian of a testator's minor grandson an individual who was in truth and fact aligned in litigation with a party asserting a claim adverse to his ward's claim. Damouth v Klock, 29 Mich 289, 296 (1874). The "wrong" was all the more "astonishing" because it was not prevented by the lower courts. Id. See also Berdan v Milwaukee Mut. Life-Ins. Co., 136 Mich 396; 99 NW 411 (1904).

17. Henry J. Warda's guardian perpetrated the identical "outrage": A. J. Warda objected on behalf of his ward to the very will under which the ward would have eventually become the exclusive residual legatee. A guardian has no authority to do anything which is detrimental to his ward. Reliance

Insurance Co. v Haney, 54 Mich App 237, 242-243; 220 NW2d 728 (1974). As in Damouth, Henry was "made to answer in denial of his own rights." This "astonishing" and "outrageous" conduct by Ethel M. Warda's husband was a clear violation of Damouth, supra. Such outrages result in recognition of constructive trusts. Nelson v Woodworth and Burton v Burton, supra.

18. The second prerequisite for a binding minor's settlement is absence of any conflict of interest on the part of the minor's legal counsel. Attorney Casper R. Grathwohl, however, occupied conflicting roles.

19. Ethel M. Warda retained Attorney Grathwohl for the 1953 William H. Matthews probate proceedings. Grathwohl was eventually paid $25,000 for

successfully defeating the Second Will under which the minor would have eventually inherited all the land. Simultaneously, Attorney Grathwohl also acted as legal advisor to A. J. Warda in his role as guardian. All of the guardian's pleadings in the probate court were prepared by Grathwohl. In his petition seeking authorization to settle , A. J. Warda represented to the court that Grathwohl had advised him that the settlement (which afforded the minor absolutely no consideration of any sort) was in the minor's best interest. Grathwohl's allegiance to the minor could not have been more compromised had he deliberately set out with that duplicitous purpose in mind.

20. The Michigan Supreme Court has stated that "[a]n attorney owing one duty

to a client and another duty to a client's adversary, each of whom have adverse interest, would be faced with an irreconcilable conflict of interest." Friedman v Dozorc, 412 Mich 1,22; 312 NW2d 585 (1981). As stated in Hightower v Detroit Edison Co., 262 Mich 1,9; 247 NW 97 (1953), "the lawyer owes his client undivided allegiance." Emphasis added.

21. In State Bar v Estes, 392 Mich 645, 651; 221 NW2d 322 (1974), the Michigan Supreme Court affirmed a one-year disciplinary suspension of a lawyer who represented a testatrix's daughter against the estate at a probate hearing, where that same attorney had drafted and witnessed the will and was then serving as coexecutor thereunder. See also, In re Schlossberg, 388 Mich 389; 200 NW2d 219 (1972); People v Doyle, 159 Mich App 632;

406 NW2d 893 (1987), People v Gallagher, 116 Mich App 283; 323 NW2d 366 (1982); and GAC Corp v Mahoney Typographers, 66 Mich App 186; 238 NW2d 575 (1975). In Olitkowski v Loan Assn, 302 Mich 303; 4 NW2d 664 (1942), an executrix brought suit against the estate's former attorney. Evidence established that while so serving, he also served as attorney for a savings and loan association into which he advised her to transfer funds. The court affirmed the imposition of a constructive trust against the lawyer insofar as the estate might be unable to secure repayment of its deposits.

22. In the instant case, Attorney Grathwohl earned his $25,000 fee by obtaining admission of the will which disinherited the minor, while he

simultaneously gave legal counsel to the minor's guardian.

23. The conflict of interests not only was potential, but had already ripened into certainty. It was the duty of the probate court--a duty that it failed to discharge -- to nip this obvious conflict in the bud. Matter of Grand Jury Proceedings, 428 F Supp 273, 277 (ED Mich 1976).

24. The probate court entirely failed to exercise such supervision over Attorney Grathwohl respecting the William H. Matthews estate. Grathwohl's conduct constituted a breach of fiduciary and attorney-client duty. See also, In re Valentino Estate, 128 Mich App 87, 91-93. 339 NW2d 698 (1983), holding that where a minor is named as an heir, the best interests of the minor's estate and the

best interests of the decedent's estate are not coextensive.

25. The third prerequisite for a valid minor's settlement is that it be "just and reasonable" with respect to the minor. In Hay v LeBus, 317 Mich 698; 27 NW2d 309 (1947), the Michigan Supreme Court ruled that a trial court has no discretion to approve a minor's settlement which "utterly extinguishes" a minor's interest in an estate unless that interest is first found to be "insubstantial". Id. at 711.

26. Determination of whether an interest is insubstantial is to be made "with reference to the basis for contest." Id. The "basis for contest" in the William H. Matthews estate concerned whether the subsequent codicil of November 19, 1952 revived the First Will

of October 2, 1950 and by implication revoked the intervening Second Will of December 4, 1950

27. Henry J. Warda's interest in the controversy was substantial, as a matter of law, because the foregoing revocation/revival issue had never before been presented to the Michigan Court of Appeals, let alone to the Michigan Supreme Court. However, all analogous Michigan case precedent indicated that the outcome would depend upon the testator's intent, a factual question that could be determined only by an evidentiary hearing. "The cardinal rule of law and the predominant rule in the construction and interpretation of testamentary instruments is that the intent of the testator governs if it is lawful and if it can be discovered." In re Dodge Trust, 121 Mich

App 527, 539; 330 NW2d 72 (1982), citing National Bank and Trust Company, 267 Mich 270; 255 NW2d 587 (1934) and In re Blodgett's Estate, 197 Mich 455; 163 NW 907 (1917).

28. As to Matthew's intent, Grathwohl admitted to the court that the testator never instructed him to draft a codicil for the purpose of revoking the Second Will and reviving the First Will. Grathwohl drafted the codicil so as to refer to the First Will rather than the Second Will only because he had no knowledge that the Second Will ever existed.

29. As of this writing, the issue of whether a subsequent codicil to a previously revoked First Will revokes the intervening Second Will and revives the First Will still has not been directly

presented to the Michigan Appellate Courts.

30. In 1953, as now, there was a split of authority between various jurisdictions. Several courts have ruled that the codicil would not revive the First Will. See, e.g., In re Foulds' Will, 21 Misc 2d 402; 196 NYS 2d 816, Aff'd 13 App Div 2d 16; 212 NYS 2d 519 (1961), In re Trost, 38 Misc 404; 77 NYS 879 (1902); and Fuller v Nazal, 259 Al 598; 67 So2d 806 (1953).

31. Under these circumstances, Henry J. Warda's interest in his grandfather's estate could not have been properly considered "insubstantial" without an independent judicial investigation to determine Matthew's probable intention. In the absence of such independent judicial investigation,

the probate court was precluded by Hay v LeBus, supra, from approving any settlement agreement that "utterly extinguished" the minor's interest without any consideration whatsoever.

32. The fourth prerequisite for a binding minor's settlement is an independent judicial investigation if its terms. The probate court, in the person of Judge Malcomb Hatfield, who was not even a licensed attorney, violated Michigan Supreme Court and Court of Appeals decisions controlling the procedure that he was required to follow in order to independently investigate the proposed settlement before approving it.

33. In footnote 3 at page 9 of its Opinion in Warda v. Commissioner, supra, the Tax Court cited In re Marxhausen's Estate, 247 Mich 192; 225 NW 632 (1929),

stating that it "exemplifies the power of Michigan courts to approve settlements and the deference that must be given to such orders." In so misconstruing Marxhausen, the Tax Court totally ignored the minimum requirements for "'independent investigation" imposed by Marxhausen. Further, the Tax Court's Opinion reflects no appreciation as to how Marxhausen fits into the line of Michigan cases imposing ever greater requirements on courts prior to the approval of a minor's settlement. Finally, the Tax Court failed to take note of all the unique facts in Marxhausen which justified the finding therein that the probate court's independent investigation of the settlement agreement was sufficient even though no oral testimony was taken at the settlement hearing.

34. Marxhausen clearly held that, even where an evidentiary hearing may not be necessary, the agreement still had to come before the court for an independent judicial investigation:

> [T]he court shall not approve a compromise as of course upon consent of the guardian, but shall investigate in order to make a judicial determination of the essentials of the settlement. Palazzolo v Judge of the Superior Court, 234 Mich 547; Dudex v Sterling Brick Co., 237 Mich 470.

Marxhausen, supra, 247 Mich at 199, emphasis added.

35. Certain inescapable conclusions can be reached with regard to the procedures that Judge Hatfield was required, but failed, to follow in

discharging his duty to independently investigate the settlement:

> (a) The order of approval "shall not" be entered "as [a matter] of course" based merely " upon the consent of the guardian." Marxhausen, supra, 247 Mich at 199.
>
> (b) The court "shall investigate" before arriving at its determination. Id.
>
> (c) The investigation "must be real, not perfunctory or merely formal." Centrala v Navrude, 30 Mich App 30, 33; 186 NW2d 35 (1971).
>
> (d) Depending upon the nature of the case and the extent of the record which the court has before it, the court's independent investigation may still be insufficient

"even though the court made some inquire . . ." Moebius v McKraken, 261 Mich 404, 414, 246 NW 163 (1933).

(e) Normally, "considerable oral and documentary proof [is] taken" (Metzner v Newman, 224 Mich 324, 330; 194 NW 1008 (1923)) at the settlement hearing; and where a guardian is appointed, he will have "filed a report [with the court] discussing at some length the various provisions of the agreement." Detroit Trust Co. v Neubauer, 325 Mich 319, 333; 38 NW2d 371 (1949). See also, Dudex v Sterling Brick Co., 237 Mich 470; 212 NW 92 (1927) and Palazzolo v Judge of the Supreme Court, 234 Mich 547; 208 NW 677 (1926), both cited with approval by Marxhausen, supra, 247 Mich at 470.

(f) Where "no testimony of any kind was taken" (Id) at the settlement hearing, the investigation will be considered insufficient unless "the court is otherwise . . . informed" of all the relevant facts. Marxhausen, supra, 247 Mich at 199.

(g) Circumstances which may alleviate the need for oral testimony (but not the need for the independent investigatory hearing itself) include instances where the controversy raises "essentially questions of law upon which no testimony was necessary;" where the relevant facts "were not disputed;" where the guardian has proven loyalty to his ward by establishing "his litigious attitude;" and where the court

is so well "acquaint[ed] with the situation" from a well developed record, including the "accounts" filed and "the general conduct of the estate," that the "judge of probate [has] obtain[ed] an intimate knowledge of the estate . . ." (Id).

(h) In the William H. Matthews estate, approval of the settlement was the very first issue to come before the court, and the court was misinformed as to the value of the estate, represented to be only $50,000 rather than its true value of $247,000. Thus, the court was not well "acquainted with the situation" from the "accounts" filed and the "general conduct of the estate." Id. A. J. Warda clearly had not proven loyalty to his ward by displaying a

> "litigious attitude." The total absence of any consideration for the minor made Matthew's probable intent a material factual issue. Evidentiary hearings are required unless "no material issues of fact were presented" In re Bontea Estate, 137 Mich App 374, 377; 358 NW2d 14 (1984), appeal denied.

36. Scrupulous review of the minor's estate file as well as of the William H. Matthew's estate file leaves no doubt but that the probate court failed to conduct any independent investigatory hearing before the minor's interest in the $247,000 estate of his grandfather (misrepresented to the court as $50,000) was utterly extinguished without any consideration. The failure of the court

to independently investigate the settlement appears on the face of the record itself. The order of August 6, 1953 recites that it was entered only: "On reading and filing the petition of Anthony J. Warda, guardian of said [minor's] estate . . .." Such is not the language used by a court when it enters an order following a hearing. Rather, it is the language used when an order is entered pro forma ("as [a matter] of course"), which is precisely what the Michigan Supreme Court ruled that the probate court "shall not" do. Marxhausen, supra. Further, the record is devoid of any notice of hearing or waiver of notice of hearing. Such a notice or waiver was required before a hearing could have been held. Obviously, the probate court

conducted no independent investigatory hearing.

37. The total failure to conduct an independent investigation of the settlement violated Michigan law to the effect that the independent judicial investigation "must be real, not perfunctory or merely formal." Centala v Navrude, 30 Mich App at 33. An actual evidentiary hearing in this particular case was all the more essential because of: (i) the conflicting roles of the guardian, (ii) the conflicting roles of the legal advisor to the minor's estate, (iii) the settlement's failure to provide any consideration whatsoever for the minor, and (iv) the erroneous information given the court as to the value of the estate.

38. This court is not required to articulate a single formula by which the outer permissible limits of conduct under Michigan law can be established in all cases with respect to conflicts of interests, judicial inattention and unconscionably inadequate consideration. Rather, this Court may rule, as did the Michigan Supreme Court in Baxter v Trust & Savings Bank, 273 Mich 642, 647; 263 NW 762 (1935), "that the conflict of interest in the instant case was sufficiently strong to make the transaction voidable." (Id.)

39. In order to rule that a constructive trust arose for the benefit of the minor, Henry J. Warda, this court need only hold that the totality of unique facts herein combined to constitute constructive fraud against the minor.

Whether any one of the deficiencies would constitute constructive fraud standing alone, is not a question that this court needs to address.

40. The fact that Ethel M. Warda herein never intended to actually defraud her son -- as evidenced by her eventual transfer of the property to him -- is irrelevant. Ryan v Chopp, 314 Mich 255; 22 NW2d 363 (1946).

41. Finally, where recognition of a constructive trust is sought, all that is required is a preponderance of the evidence. Mackey v Baker, 327 Mich 57; 41 NW2d 331 (1950), citing Stephenson v Goldner, 279 Mich 710; 276 NW849 (1938).

RELIEF

IT IS FURTHER ORDERED AND ADJUDGED That, pursuant to MCL 700.22(i); MSA

27.5022(i), this Court is empowered to "impose a constructive trust."

IT IS FURTHER ORDERED AND ADJUDGED That the appropriate relief, under all the facts and circumstances herein, is to recognize and impose a constructive trust, and this Court does hereby so recognize and impose a constructive trust, in favor of Henry J. Warda as constructive beneficiary, and against his mother, Ethel M. Warda, as constructive trustee, with respect to all property, both real and personal, which Ethel M. Warda inherited from decedent herein, William H. Matthews, by virtue of that certain family settlement agreement herein dated July 25, 1953, the order approving same as to the minor, Henry J. Warda, dated August 6, 1953, and the order assigning residue dated August 4,1954, as well as with

respect to all property traceable to such inheritance, to the full extent of its present value.

IT IS SO ORDERED.

ENTERED: This ___ day of December, 1992

_____
Wilbur Schillinger
Judge of Probate

T.C. Memo. 1992-43

UNITED STATES TAX COURT

ETHEL M. WARDA,
Petitioner
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent

Docket No. 23134-89 Filed January 22,1992

Peter J. Johnson and Jay L. Schultz, for petitioner.

James F. Mauro and Tanya M. Marcum, for respondent.

MEMORANDUM FINDINGS OF FACT AND OPINION

JACOBS, Judge: Respondent determined the following deficiencies in and additions to petitioner's Federal gift tax:

Tax Period Ending	Deficiency	Additions to Tax Sec. 6651 (a)(1)
12/31/68	$ 17,550	$ 4,388
6/30/79	81,780	20,445
6/30/80	57,190	14,298
12/31/82	67,744	16,936
12/31/83	118,297	29,574

All section references are to the Internal Revenue Code as amended and in effect for the tax periods in issue. All Rule references are to the Tax Court Rules of Practice and Procedure.

After concessions, the only remaining dispute concerns the proper characterization of transfers of farm properties located in Berrien and Cass Counties, Michigan, from Ethel M. Warda (petitioner) to her son and daughter-in-law, Henry J. and Jeanette Warda (Henry and Jeanette). Respondent contends said transfers were taxable gifts. Petitioner contends said transfers were either nontaxable distributions of

corpus from a constructive trust or were sales. If we find that said transfers were taxable gifts, then we must further determine: (1) The dates the gifts were made; (2) the fair market value of the properties transferred on the date of donation; and (3) whether petitioner is liable for additions to tax for failure to file Federal gift tax returns.

FINDINGS OF FACT

Some of the facts have been stipulated and are so found. The stipulation of facts and the exhibits attached thereto are incorporated herein by this reference.

Ethel M. Warda resided in Berrien Springs, Michigan, at the time she filed her petition in this case. She did not file Federal gift tax returns for any of the tax periods in issue.

Background

Petitioner's father, William H. Matthews, died testate on July 1, 1953. Following William H. Matthews' death, petitioner and her stepmother asserted competing claims to his estate. Petitioner, her stepmother, and A. J. Warda (petitioner's husband), as guardian of Henry, then a minor, settled their dispute on August 4, 1953. Based on this settlement, the Probate Court for the County of Berrien, Michigan, awarded petitioner the entire residuary estate of William H. Matthews, which included the properties at issue herein.[1]

Petitioner grew up on the farm properties she inherited and worked the land from an early age. She was later joined in this endeavor

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[1] On October 22, 1990, petitioner and Henry petitioned to reopen the estate proceeding with the objective of changing the Michigan probate court's award of the estate's assets. As of the date of this Opinion, no disposition of this matter by the probate court has been made.

by her husband and Henry. In 1960, following petitioner's separation from her husband, Henry took over the management of the farm at petitioner's request.

In 1961, Henry, Jeanette, and their children moved into the main farm house, and petitioner moved to a smaller house on the farm. At such time, petitioner's involvement in the day-to-day farm operations diminished. She continued, however, to receive a share of the crop proceeds as well as additional support from Henry and Jeanette.

Transfer of the Properties

On February 28, 1962, petitioner entered into a written contract with Henry and Jeanette (the 1962 contract) for the sale of the property on which she resided (home farm property); the 1962 contract was never recorded. The

stated consideration for the property was $26,000: $1,000 down, and the $25,000 balance to be paid "$3,000 or more annually - $1,500 October 1, 1962, $1,500 April 1, 1963. Payable semiannually each and every year, interest at 4% being included in said payments."

The 1962 contract has a "payment record" on its last page. This record reflects payment of the $1,000 down payment, a $3,000 payment on May 26, 1963, and a $3,000 payment on April 1, 1964. Petitioner signed each notation of these payments. No other payments are reflected in the payment record.

Although the 1962 contract was signed in 1962, the deed to the home farm property was executed and recorded on December 2, 1968.

Within a few months after entering into the 1962 contract, petitioner and Henry

purportedly entered into oral contracts (the purported oral contracts) with regard to five other properties owned by petitioner. The deeds to these properties were executed and recorded in 1979 (twice), 1980, 1982, and 1983, respectively (the 1979, 1980, 1982, and 1983 properties). Petitioner asserts that the total price for all five properties was $35,000 and that payment was to be made from the proceeds generated from the sale of the crops raised on the properties. No evidence of payment was introduced.

Petitioner paid property taxes with respect to each property until the date the property was deeded to Henry and Jeanette.

Fair Market Values of Real Estate

The parties stipulated the following fair market values, as of the dates stated, for the properties at issue:

	Stipulated Fair Market Value on Date Deed Executed & Recorded
482.92 acres in Sections 5 and 6, Niles Township, Berrien County, Michigan, (the home farm property) deed dated 12/02/68.[1]	$135,000
92.3 acres in Section 18, Howard Township, Cass County, Michigan, deed dated 6/20/79.	$ 96,000
160 acres in Section 19, Howard Township, Cass County, Michigan, deed dated 6/20/79.	$162,000

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[1] Petitioner contends that the 1968 fair market value for the home farm property is not relevant. She argues that this property should be valued as of Feb. 28, 1962, the date of the 1962 contract. In contrast, respondent considers the 1962 fair market value to be irrelevant.

159.01 acres in Section 24, Berrien Township, Berrien County, Michigan, deed dated 4/29/80.	$180,000
158.29 acres in Section 18, Howard Township, Cass County Michigan, deed dated 8/27/82.	[2]$222,000
297.17 acres in Sections 31 and 32, Berrien Township, Berrien County, Michigan, deed dated 2/02/83.	$348,500

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[2] The Parties are that petitioner made a gift of her one-half interest in this parcel to Henry and Jeanette during the tax period ending Dec. 31, 1982. The stipulated fair market value is for a 100-percent ownership interest.

Income Tax Audit

The gift tax deficiency at issue arose out of an income tax audit of Henry and Jeanette. The audit addressed whether Henry and Jeanette received the 1979, 1980, 1982, and 1983 properties for services rendered. In an attempt to explain the nature of the transfers, petitioner sent a notarized letter to the revenue agent stating that she deeded the properties to Henry in consideration for his "time, labor and material[s]."

Shortly after petitioner sent the letter, Henry hired a certified public accountant to review the tax consequences of his receipt of the properties. The accountant prepared affidavits for petitioner's signature characterizing the transfers of the 1979, 1980, 1982, and 1983 properties as gifts. Petitioner signed the affidavits declaring that she intended

to transfer the properties as gifts to Henry and Jeanette. Based on this information, the revenue agent terminated the income tax audit of Henry and Jeanette.

Notice of Deficiency

In his notice of deficiency, respondent determined that transfers of the home farm property and the 1979, 1980, 1982, and 1983 properties by petitioner to Henry and Jeanette constituted taxable gifts. He also determined that petitioner was liable for additions to tax for failure to file Federal gift tax returns.

ULTIMATE FINDINGS OF FACT

1. Petitioner's transfers of the 1979, 1980, 1982, and 1983 properties to Henry and Jeanette were taxable gifts.

2. The gifts of the 1979, 1980, 1982, and 1983 properties were made on the dates that the respective deeds were executed and recorded.

3. The home farm property was transferred to Henry and Jeanette on February 28, 1962.

4. The value of petitioner's one-half interest in the 1982 property was 50 percent of the fair market value of the property on the date of donation.

5. Petitioner's failure to file Federal gift tax returns was due to willful neglect and not due to reasonable cause.

OPINION

We presume respondent's determinations in his notice of deficiency are correct.

Petitioner bears the burden of overcoming this presumption. Rule 142(a).

Section 2501 imposes a tax on the transfer of property by gift; section 2512(b) provides that "Where property is transferred for less than an adequate and full consideration in money or money's worth, then the amount by which the value of the property exceeded the value of the consideration shall be deemed a gift". Whether the gift tax applies depends on the objective facts of the transfer and the circumstances under which the transfer is made, not on the donor's subjective motives. Sec. 25.2511-1(g)(1), Gift Tax Regs.

Respondent posits that petitioner transferred all the properties in issue to Henry and Jeanette for less than adequate and full consideration and thus the transfers were subject to gift tax.

Petitioner first argues that since she was not the rightful owner of the properties, she made no gifts. Her argument is based on the premise that her acquisition of the properties resulted from an erroneous decision of the Michigan probate court, i.e., petitioner should not have been granted a fee simple interest in the properties.[2] We address petitioner's argument simply by stating that we defer to the Michigan probate court's order.[3] The terms of the order speak for themselves: petitioner

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2 Specifically, petitioner argues that, based on her father's second will, the probate court should have determined that he left his estate to a trust which granted petitioner only a life estate in the income from the trust plus use of the home farm property. Petitioner contends that upon her death the trust was to be dissolved and the entire corpus distributed in fee simple absolute to Henry. Accordingly, she argues that the subsequent transfers of the properties from her to Henry and Jeanette were nontaxable distributions from a constructive trust, rather than gifts.

3 Petitioner cites the Michigan case of In re Marxhausen's Estate, 225 N.W. 632 (Mich. 1929), as authority for overturning a Michigan probate court's order. That case does not support petitioner's argument . To the contrary, that case exemplifies the power of Michigan probate courts to approve settlements and the deference that must be given to such orders.

received a fee simple interest in the properties she inherited from her father. Accordingly, we reject petitioner's argument.

Petitioner alternatively argues that if the transfers were gifts, then the gifts were completed for tax purposes in 1962. In addressing this argument, we must first decide whether petitioner transferred the properties to Henry and Jeanette as gifts.

1. The Transfers of the 1979, 1980, 1982, and 1983 Properties Were Gifts Not Sales

We are mindful that transactions within a family group are subject to special scrutiny; the presumption is that a transfer between family members is a gift. Estate of Reynolds v. Commissioner, 55 T.C. 172, 201 (1970).

Petitioner failed to prove that Henry and Jeanette paid any consideration for the 1979,

1980, 1982, and 1983 properties. The deeds for these properties state that the consideration which Henry and Jeanette paid was either a small fraction of the properties' fair market value or a nominal amount, such as $1. Henry testified that he paid petitioner for all the properties. His testimony and the testimony of the other interested parties was not specific, persuasive, or conclusive. We discount his testimony because we find it self-serving and unworthy of belief. Tokarski v. Commissioner, 87 T.C. 74, 77 (1986). In addition, the sworn affidavits signed by petitioner on the occasion of Henry's income tax audit stated that the transfers were gifts and that no consideration was paid.

We find that Henry and Jeanette did not give any consideration to petitioner for the 1979, 1980, 1982, and 1983 properties.

Further, we do not believe that there were oral contracts for these properties.[4] We hold that petitioner transferred the 1979, 1980, 1982, and 1983 properties to Henry and Jeanette for less than an adequate and full consideration in money or money's worth. Accordingly, the transfers of such properties constituted gifts, subject to the gift tax imposed by section 2501.

2. The Gifts of the 1979, 1980, 1982, and 1983 Properties Were Made on the Dates the Deeds Were Executed and Recorded

It is axiomatic that the value of property can vary over time. Thus, to determine the amount of each gift, we must decide the respective date of its transfer.

Respondent determined that each transfer of property occurred on the date the

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4 We are mindful that Michigan's statute of frauds provides that agreements for the sale of real property are invalid unless in writing. Mich. Stat. Ann. sec. 26.908 (Callaghan 1982).

deed was executed and recorded. Petitioner contends that all of the transfers occurred in 1962, the year the 1962 contract was signed and the purported oral contracts were made.

We have identified the following elements of a completed gift:

> (1) A donor competent to make the gift; (2) a donee capable of taking the gift; (3) a clear and unmistakable intention on the part of the donor to absolutely and irrevocably divest himself of the title, dominion, and control of the subject matter of the gift, in praesenti; (4) the irrevocable transfer of the present legal title and of the dominion and control of the entire gift to the donee, so that the donor can exercise no further act of dominion or control over it; (5) a delivery by the donor to the donee of the subject of the gift or of the most effectual means of commanding the dominion of it; (6) acceptance of the gift by the donee * * * [Guest v. Commissioner, 77 T.C. 9, 16 (1981) (quoting Weil v. Commissioner, 31 B.T.A. 899, 906 (1934), affd. 82 F.2d 561 (5th Cir. 1936))].

We agree with respondent that the 1979, 1980, 1982, and 1983 properties were transferred on the dates the deeds for such properties were executed and recorded. Having observed and evaluated the demeanor of petitioner and her witnesses, we are unable to give credence to their testimony. Petitioner failed to prove that she had "a clear and unmistakable intention * * * to absolutely and irrevocably divest * * * [herself] of the title, dominion, and control" of the 1979, 1980, 1982, and 1983 properties in 1962, within the meaning of element (3). And, as previously stated, we do not believe that the purported oral contracts existed.

3. Home Farm Property Was Transferred in 1962

We find that the home farm property was transferred from petitioner to Henry and

Jeanette on February 28, 1962, a tax period not before us.

Respondent cites Estate of Whitt v. Commissioner, 751 F.2d 1548 (11th Cir. 1985), affg. T.C. Memo 1983-262, to support his argument that petitioner's gift of the home farm property occurred in 1968 when the deed was recorded. In Estate of Whitt v. Commissioner, supra at 1560-1561, the Eleventh Circuit Court of Appeals held that this Court's finding that the gifts were complete when the deeds were recorded and not when the deeds were executed was not clearly erroneous. The Eleventh Circuit noted that under the applicable state recording act, a grantor could defeat an unrecorded deed by executing a deed to the same property to a bona fide purchaser. Id. at 1561. The Eleventh Circuit stated:

> We do not say that in every instance a gift of real property is incomplete for federal tax purposes until the deed of conveyance is recorded. All we are saying is that in this case there were sufficient facts from which the Tax Court could conclude that these gifts were not intended to be completed until the recordation of the respective deeds. * * * [Id.]

Even though the deed for the home farm property was not recorded until 1968, the evidence in this case supports a finding that the transfer of the home farm property (as between petitioner and Henry and Jeanette) was completed in February 1962.

4. Value of Petitioner's Interest in the 1982 Property Was 50 Percent of Its Fair Market Value

The parties stipulated that petitioner and Henry owned the 1982 property as joint tenants and that the property's fair market value (as a whole) was $222,000 on August 27,

1982. Having considered the parties' arguments as to the value of petitioner's interest in this property, we hold that the value of the one-half interest transferred by petitioner on August 27, 1982, was 50 percent of the fair market value of the whole, or $111,000.

As to the value of the 1979, 1980, and 1983 properties, we adopt their respectively stipulated fair market values on the dates the deeds were executed and recorded.

5. Petitioner's Failure to File Was Due to Willful Neglect

Respondent determined that petitioner is liable for the additions to tax imposed by section 6651(a)(1). That section imposes and addition to tax for failure to file a return in a timely manner, unless it is shown that such failure was due to reasonable cause and not due

to willful neglect. Petitioner bears the burden of proving reasonable cause. Heman v. Commissioner, 32 T.C. 479, 490 (1959), affd. 283 F.2d 227 (8th Cir. 1960). There is no question that petitioner did not file gift tax returns. As a result, we need only decide whether her failure was due to reasonable cause.

Petitioner is knowledgeable taxpayer. She has had extensive dealings in land transactions over the years. She has a lifetime of experience in the farming business and has generated substantial personal income from investments in corporate and government securities. See Warda v. Commissioner, T.C. Memo. 1988-572; Warda v. Commissioner, T.C. Memo. 1985-601.

There is nothing in the record which would indicate that petitioner sought and relied on the advice of counsel regarding the filing (or nonfiling) of gift tax returns; thus, petitioner's

mistaken belief that no returns were due does not constitute reasonable cause for noncompliance. Heman v. Commissioner, supra at 490. Accordingly, respondent's determination as to the section 6651 (a)(1) additions to tax is sustained.

Decision will be entered under Rule 155.